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SUBJECT: IS THE EGYPTIAN GOVERNMENT READY FOR A GLOBAL SLOWDOWN?

Sensitive but unclassified. Please handle accordingly.

**¶1.** (SBU) Summary: Egypt's stock market, like nearly all globally, has been significantly down this year and the global financial crisis has only accelerated that decline. The index is down 50 percent from its April historic highs, and in October, the most intense period of global financial crisis, the local index shed more than 20 percent of its value. That said, just a small percentage of Egyptians are invested in the stock market, Egyptian banks are very conservative, and Egypt enters this volatile period with strong growth, so Egypt's real economy has seen relatively little specific impacts from the financial crisis. However, the Government would probably like to believe that it is more immune than it is. President Mubarak has held two Cabinet meetings with his economic team recently, and several members of the economic team have spoken publicly about planned reforms and other initiatives to ease the economic impact of ongoing financial turmoil, including an October 12 press conference by Prime Minister Nazif and an October 19 speech at the AmCham by Minister of Trade Rachid. The message has been that Egypt's financial system is safe, that the GOE is monitoring the situation, and that even in a global recession Egypt will weather the storm better than others. While we are not aware of any comprehensive assessments done by the GOE on the specific risks Egypt faces in this global crisis, some ministers have mentioned some "new plans" and "incentives" in the press, none of which contain specificity. End Summary.

**¶2.** (U) At a speech to the Amcham on October 16, Minister of Trade and Industry Rachid warned that although the Egyptian banking sector is sound, Egypt is nonetheless likely to suffer from the global economic crisis that he predicted would inevitably follow the current period of financial turmoil. Following the lines of the IMF's World Economic Outlook he said, that as OECD countries slow, growth in 2009 will come from emerging markets, including China, India, Indonesia and Egypt. He expressed concern, however, that a protectionist trend may emerge and said that WTO's Lamy had called him about an emergency meeting. The financial crisis, he said, is a "hurricane that must pass" but noted that it would create opportunities for some companies and countries. On the positive side, for Egypt, the drop in commodity prices would lead to a drop in inflation, which, at 20-plus percent year-on-year, has been one of Egypt's biggest economic concerns.

**¶3.** (U) In the case of Egypt's banking sector, which Central Bank Governor El Okdah publicly described last week as "highly liquid," Rachid observed deposits are safe and lending continues. This stability has meant that the GOE's economic team has been able to focus on the looming economic slowdown which Rachid predicted would affect Egypt's exports, and other significant sources of forex, including tourism, foreign direct investment, remittances and Suez Canal revenues. Egypt has been spared the financial crisis, he

said, noting that the GOE now needs to be forward thinking on sectoral initiatives to "at least minimize the damage" if not take "full opportunity of the disruption."

**¶14.** (U) Rachid said that under current economic conditions, the appropriate policy response in Egypt is "a higher level of engagement" on economic reform. To continue at the same pace, he said, would be to lose ground and see GDP growth rates fall to 3-5 percent. Egypt needs 7 percent GDP growth to control unemployment and address poverty. His goal, he said, is full manufacturing utilization rates, no layoffs, and completion of the 1000 factories now under construction. To meet these goals, he said, the GOE will design a set of reforms and measures for every sector, with an overall strategy of: ensuring adequate access to finance, continuing to attract private investment, including by Egyptians, and maintaining the government's infrastructure investment program. This will include pushing Egyptian banks to increase their lending activities. He also suggested that he will engage more actively with emerging markets such as Turkey and China, and maintain trade and investment flows with India and Africa.

**¶15.** (SBU) Rachid's remarks followed an October 12 press conference by Prime Minister Nazif, Central Bank Governor El Okdah and Minister of Investment Mohieldin in which they recited many of the statistics which indicate Egypt's financial stability and safety. El Okdah reviewed the strong position of the Egyptian financial system, in part due to reforms begun in 2004; noting that net international reserves (NIR) are safe and are in Treasury bonds in safe countries; the NIR is diversified; Egyptian banks have a relatively small amount invested overseas; and loan-to-deposit ratios are much lower in Egypt than in other countries.

**¶16.** (SBU) All of these things are true. Egypt has been relatively slow to introduce new financial products, which in the current environment, makes them appear wise. Also, the CBE's bank reform program of the last few years has contributed to the improved asset quality and the more cautious approach towards lending of most banks. While this has led to low credit availability and a slow credit growth, it leaves the banks in good stead in this environment. However, while starting from a very low base, the last several years have seen growth in some new financial instruments like mortgages, credit cards, and consumer credit. While this type of credit is still a relatively small portion of overall credit, and it is primarily concentrated in a small handful of banks, some analysts are already warning that given the lack of familiarity with a credit culture and absent better financial literacy, that even this small amount of new credit could begin to pose some system risks.

**¶17.** (U) In the period between the Nazif press conference and the Rachid speech, several sectoral ministers hinted at the kind of reforms the GOE may be contemplating. Transport Minister Mansour, for example, hopes to attract more investment in ports and road projects. Housing Minister Al Mahgrabi said a new plan will be announced to boost activity in the building materials sector. In addition to announcing delays in removing energy and other subsidies in the industrial zones, and eliminating the export tax on cement, Rachid has said that Egypt's Export Guarantee Company will receive additional capital. He also said new incentives could be offered to license industrial projects, and credit for industrial projects could be enhanced. Rachid told the Ambassador on the margins of the Amcham speech that he hoped to use the urgency of the crisis to accelerate additional economic reform.

**¶18.** (SBU) Additionally, the Ministry of Investment (MOI) will use financial crisis to push implementation of an existing plan to create a single regulator for the Capital Markets Authority, the Mortgage Finance Authority and the Insurance Authority. MOI has been working on this key reform measure for some time. Mohieldin told us over the weekend that the ministry will cite the financial crisis when it submits the draft single regulator law to parliament in November. According to the minister's advisor, MOI will argue that the draft law is a key part of the GOE's response to the financial crisis, and ask parliament to pass the law expeditiously. MOI is targeting January 1 for passage of the new law, but the minister's advisor said it could possibly happen by the end of November.

¶9. (SBU) Comment: There are few specifics of any of the "new proposals" being discussed, and given an absence of analysis about how slower global growth will affect Egypt, it is hard to know exactly where Egypt should focus any "new efforts." Clearly Egypt's economy is linked to external developments, so reductions in tourism, Suez Canal receipts, and foreign direct investment could all contribute to slower growth. Clogged credit markets have reportedly already started affecting exporters who depend on letters of credit in order to ship goods. Anecdotally, we have heard bankers mention that the L/C market has been affected, something that will impact Egypt's export-dependent growth strategy. That said, Egypt has a large domestic demand, an increasingly diversified manufacturing base, a huge government sector which continues to employ huge masses, so even if growth drops off, it will still be above historical norms. And, while oil prices are falling, and Gulf countries may have less to invest, they still are relatively well off to continue to invest in Egypt.

¶10. (SBU) Comment (cont): Egypt's reformers have been riding a wave of global praise in recent years, so in some ways may think of themselves as infallible. Global financial crisis or not, the economic team needs to redouble its efforts to keep Egyptian growth at a high and sustainable level and to fix the inequitable growth which has worsened with years of inefficient subsidies. While subsidy reform was a part of Mubarak's lexicon after last year's NDP party conference, it has disappeared in the current environment; Rachid refused to answer a question at the AmCham on removing subsidies. Given the declining cost of commodities and lack of political will to take on tough reforms, we expect that the GOE will continue to use subsidies as its principal way to help the poor. While this may help with public perceptions, it ignores long-awaited reforms needed for long-term economic growth in the areas of the education, land ownership, housing, the civil service and the welfare system. It is worth noting that Finance Minister Boutros-Ghali has not yet weighed in publicly. It will be interesting to see if any "incentives" which are rolled out run counter to his goal of fighting the deficit.

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